

as the modifications required by paragraph (a)(1) of this section. Thus, for example, the special deductions for dividends received, etc., provided in part VIII of subchapter B (other than section 248), as well as the net operating loss deduction under section 172, are not allowed in computing the net operating loss of a qualified real estate investment trust.

[T.D. 8107, 51 FR 43345, Dec. 2, 1986]

§ 1.172-3 Net operating loss in case of a taxpayer other than a corporation.

(a) *Modification of deductions.* A net operating loss is sustained by a taxpayer other than a corporation in any taxable year if and to the extent that, for such year there is an excess of deductions allowed by chapter 1 of the Internal Revenue Code over gross income computed thereunder. In determining the excess of deductions over gross income for such purpose:

(1) *Items not deductible.* No deduction shall be allowed under:

(i) Section 151 for the personal exemptions or under any other section which grants a deduction in lieu of the deductions allowed by section 151.

(ii) Section 172 for the net operating loss deduction, and

(iii) Section 1202 in respect of the net long-term capital gain.

(2) *Capital losses.* (i) The amount deductible on account of business capital losses shall not exceed the sum of the amount includible on account of business capital gains and that portion of nonbusiness capital gains which is computed in accordance with paragraph (c) of this section.

(ii) The amount deductible on account of nonbusiness capital losses shall not exceed the amount includible on account of nonbusiness capital gains.

(3) *Nonbusiness deductions*—(i) *Ordinary deductions.* Ordinary nonbusiness deductions shall be taken into account without regard to the amount of business deductions and shall be allowed in full to the extent, but not in excess, of that amount which is the sum of the ordinary nonbusiness gross income and the excess of nonbusiness capital gains over nonbusiness capital losses. See paragraph (c) of this section. For pur-

poses of section 172, nonbusiness deductions and income are those deductions and that income which are not attributable to, or derived from, a taxpayer's trade or business. Wages and salary constitute income attributable to the taxpayer's trade or business for such purposes.

(ii) *Sale of business property.* Any gain or loss on the sale or other disposition of property which is used in the taxpayer's trade or business and which is of a character that is subject to the allowance for depreciation provided in section 167, or of real property used in the taxpayer's trade or business, shall be considered, for purposes of section 172(d)(4), as attributable to, or derived from, the taxpayer's trade or business. Such gains and losses are to be taken into account fully in computing a net operating loss without regard to the limitation on nonbusiness deductions. Thus, a farmer who sells at a loss land used in the business of farming may, in computing a net operating loss, include in full the deduction otherwise allowable with respect to such loss, without regard to the amount of his nonbusiness income and without regard to whether he is engaged in the trade or business of selling farms. Similarly, an individual who sells at a loss machinery which is used in his trade or business and which is of a character that is subject to the allowance for depreciation may, in computing the net operating loss, include in full the deduction otherwise allowable with respect to such loss.

(iii) *Casualty losses.* Any deduction allowable under section 165(c)(3) for losses of property not connected with a trade or business shall not be considered, for purposes of section 172(d)(4), to be a nonbusiness deduction but shall be treated as a deduction attributable to the taxpayer's trade or business.

(iv) *Self-employed retirement plans.* Any deduction allowed under section 404, relating to contributions of an employer to an employees' trust or annuity plan, or under section 405(c), relating to contributions to a bond purchase plan, to the extent attributable to contributions made on behalf of an individual while he is an employee within the meaning of section 401(c)(1), shall not be treated, for purposes of section

172(d)(4), as attributable to, or derived from, the taxpayer's trade or business, but shall be treated as a nonbusiness deduction.

(v) *Limitation.* The provisions of this subparagraph shall not be construed to permit the deduction of items disallowed by subparagraph (l) of this paragraph.

(b) *Treatment of capital loss carryovers.* Because of the distinction between business and nonbusiness capital gains and losses, a taxpayer who has a capital loss carryover from a preceding taxable year, includible by virtue of section 1212 among the capital losses for the taxable year in issue, is required to determine how much of such capital loss carryover is a business capital loss and how much is a nonbusiness capital loss. In order to make this determination, the taxpayer shall first ascertain what proportion of the net capital loss for such preceding taxable year was attributable to an excess of business capital losses over business capital gains for such year, and what proportion was attributable to an excess of nonbusiness capital losses over nonbusiness capital gains. The same proportion of the capital loss carryover from such preceding taxable year shall be treated as a business capital loss and a nonbusiness capital loss, respectively. In order to determine the composition (business—nonbusiness) of a net capital loss for a taxable year, for purposes of this paragraph, if such net capital loss is computed under paragraph (b) of § 1.1212-1 and takes into account a capital loss carryover from a preceding taxable year, the composition (business—nonbusiness) of the net capital loss for such preceding taxable year must also be determined. For purposes of this paragraph, the term *capital loss carryover* means the sum of the short-term and long-term capital loss carryovers from such year. This paragraph may be illustrated by the following examples:

Example 1. (i) A, an individual, has \$5,000 ordinary taxable income (computed without regard to the deductions for personal exemptions) for the calendar year 1954 and also has the following capital gains and losses for such year: Business capital gains of \$2,000; business capital losses of \$3,200; nonbusiness capital gains of \$1,000; and nonbusiness capital losses of \$1,200.

(ii) A's net capital loss for the taxable year 1954 is \$400, computed as follows:

Capital losses	\$4,400
Capital gains	3,000
Excess of capital losses over capital gains	1,400
Less: \$1,000 of such ordinary taxable income	1,000
Net capital loss for 1954	400

(iii) A's capital losses for 1954 exceeded his capital gains for such year by \$1,400. Since A's business capital losses for 1954 exceeded his business capital gains for such year by \$1,200, 6/7ths (\$1,200/\$1,400) of A's net capital loss for 1954 is attributable to an excess of his business capital losses over his business capital gains for such year. Similarly, 1/7th of the net capital loss is attributable to the excess of nonbusiness capital losses over nonbusiness capital gains. Since the capital loss carryover for 1954 to 1955 is \$400, 6/7ths of \$400, or \$342.86, shall be treated as a business capital loss in 1955; and 1/7th of \$400, or \$57.14, as a nonbusiness capital loss.

Example 2. (i) A, an individual who is computing a net operating loss for the calendar year 1966, has a capital loss carryover from 1965 of \$8,000. In order to apply the provisions of this paragraph, A must determine what portion of the \$8,000 carryover is attributable to the excess of business capital losses over business capital gains and what portion thereof is attributable to the excess of nonbusiness capital losses over nonbusiness capital gains. For 1965, A had \$10,000 ordinary taxable income (computed without regard to the deductions for personal exemptions), and a short-term capital loss carryover of \$6,000 from 1964. In order to determine the composition (business—nonbusiness) of the \$8,000 carryover from 1965, A first determines that of the \$6,000 carryover from 1964, \$5,000 is a business capital loss and \$1,000 is a nonbusiness capital loss. This must be done since, under paragraph (b) of § 1.1212-1, the net capital loss for 1965 is computed by taking into account the capital loss carryover from 1964. A's capital gains and losses for 1965 are as follows:

	1965	Carried over from 1964
Business capital gains	\$2,000	0
Business capital losses	3,000	\$5,000
Nonbusiness capital gains	4,000	0
Nonbusiness capital losses	6,000	1,000

(ii) A's net capital loss for the taxable year 1965 is \$8,000, computed as follows:

Capital losses (including carryovers)	\$15,000
Capital gains	6,000
Excess of capital losses over capital gains	9,000
Less: \$1,000 of such ordinary taxable income	1,000
Net capital loss for 1965	8,000

(iii) A's capital losses, including carryovers, for 1965 exceeded his capital gains for such year by \$9,000. Since A's business capital losses for 1965 exceeded his business capital gains for such year by \$6,000, 2/3rds (\$6,000/\$9,000) of A's net capital loss for 1965 is attributable to an excess of his business capital losses over his business capital gains for such year. Similarly, 1/3rd of the net capital loss is attributable to the excess of nonbusiness capital losses over nonbusiness capital gains. Since the total capital loss carryover from 1965 to 1966 is \$8,000, 2/3rds of \$8,000, or \$5,333.33, shall be treated as a business capital loss in 1966; and 1/3rd of \$8,000, or \$2,666.67, as a nonbusiness capital loss.

(c) *Determination of portion of nonbusiness capital gains available for the deduction of business capital losses.* In the computation of a net operating loss a taxpayer other than a corporation must use his nonbusiness capital gains for the deduction of his nonbusiness capital losses. Any amount not necessary for this purpose shall then be used for the deduction of any excess of ordinary nonbusiness deductions over ordinary nonbusiness gross income. The remainder, computed by applying the excess ordinary nonbusiness deductions against the excess nonbusiness capital gains, shall be treated as nonbusiness capital gains and used for the purpose of determining the deductibility of business capital losses under paragraph (a)(2)(i) of this section. This principle may be illustrated by the following example:

Example. (1) A, an individual, has a total nonbusiness gross income of \$20,500, computed as follows:

Ordinary gross income	\$7,500
Capital gains	13,000
Total gross income	20,500

(2) A also has total nonbusiness deductions of \$16,000, computed as follows:

Ordinary deductions	\$9,000
Capital loss	7,000
Total deductions	16,000

(3) The portion of nonbusiness capital gains to be used for the purpose of determining the deductibility of business capital losses is \$4,500, computed as follows:

Nonbusiness capital gains	\$13,000
Less: Nonbusiness capital loss	7,000
Excess to be taken into account for purposes of paragraph (a)(3)(i) of this section	6,000
Ordinary nonbusiness deductions	\$9,000

Less: Ordinary nonbusiness gross income	7,500
	1,500
Portion of nonbusiness capital gains to be used for purposes of paragraph (a)(2)(i) of this section	4,500

(d) *Joint net operating loss of husband and wife.* In the case of a husband and wife, the joint net operating loss for any taxable year for which a joint return is filed is to be computed on the basis of the combined income and deductions of both spouses, and the modifications prescribed in paragraph (a) of this section are to be computed as if the combined income and deductions of both spouses were the income and deductions of one individual.

(e) *Illustration of computation of net operating loss of a taxpayer other than a corporation—(1) Facts.* For the calendar year 1954 A, an individual, has gross income of \$483,000 and allowable deductions of \$540,000. The latter amount does not include the net operating loss deduction or any deduction on account of the sale or exchange of capital assets. Included in gross income are business capital gains of \$50,000 and ordinary nonbusiness income of \$10,000. Included among the deductions are ordinary nonbusiness deductions of \$12,000 and a deduction of \$600 for his personal exemption. A has a business capital loss of \$60,000 in 1954. A has no other items of income or deductions to which section 172(d) applies.

(2) *Computation.* On the basis of these facts, A has a net operating loss for 1954 of \$104,400, computed as follows:

Deductions for 1954 (as specified in first sentence of subparagraph (1))	\$540,000
Plus: Amount of business capital loss (\$60,000) to extent such amount does not exceed business capital gains (\$50,000)	50,000
Total	590,000
Less: Excess of ordinary nonbusiness deductions over ordinary nonbusiness gross income (\$12,000 minus \$10,000)	\$2,000
Deduction for personal exemption	600
	\$2,600
Deductions for 1954 adjusted as required by section 172(d)	587,400
Gross income for 1954	483,000
Net operating loss for 1954	104,400

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